Introduction

In contrast to previous years when other topics were also discussed,* Economic Issues 2015 *focuses on fiscal developments and fiscal policy. Since the first issue in 2007, the publication has dealt with topics for which we believe that require response of economic policy. In previous years, it addressed challenges related to fiscal policy, the labour market, the banking system and corporate debt. This year's publication focuses on fiscal policy issues, presenting an overview of the state of the public finances, assessing the medium-term fiscal consolidation plan, and highlighting dilemmas related to the introduction of fiscal rules and institutions for fiscal policy monitoring.

Summary

After the onset of the crisis, significant deviations from the established fiscal policy rules and their negative impact on other economic policies led to closer fiscal policy coordination in the EU. The Treaty on Stability, Coordination and Governance in the Economic and Monetary Union signed in 2012 introduced a rule on a balanced government budget, which means that under normal conditions the structural balance may not be lower than -0.5% of GDP. This rule was given additional weight by the request for it to be transferred into national legislation. The treaty also set the minimum standards for the national budgetary frameworks of EU Member States. Under the new regulations, euro area countries are requested to submit their draft budgetary plans to the European Commission (EC), which monitors the execution of medium-term budgetary plans and may, in the event of serious non-compliance with EU rules, request a revised draft plan. The sanction system has become more gradual, and sanctions for not complying with the rules of the Stability and Growth Pact can now be applied at an earlier stage. The reformed framework enables better coordination of economic policies and earlier detection of imbalances, but it has also become very complex and difficult to monitor.

A significant feature of the reformed framework of fiscal policy coordination is the introduction of numerical fiscal rules, which place special emphasis on the structural balance. Reducing the deviations from the objectives and ensuring consistent fiscal governance over the entire business cycle should be achieved by incorporating binding fiscal rules into national legislation. In order to be effective, fiscal rules should be well defined, transparent, simple and enforceable. Euro area countries have already transposed the balanced budget rule into their national laws. Although the structural balance is a better indicator of the fiscal position than the actual general government balance, it also has its flaws, which are mainly related to the volatility of output gap calculations and the variations in defining one-off factors. About half of the euro area countries have complemented the balanced budget rule with an expenditure rule or a debt rule. Given their strengths and weaknesses, a combination of rules tends to be more effective than either rule alone.

The reformed framework of fiscal policy coordination also envisages the establishment of independent fiscal institutions for fiscal policy monitoring and defines their main tasks. Independent fiscal institutions monitor compliance with fiscal rules and the functioning of the corrective mechanism, produce or validate macroeconomic forecasts, and publicly release their estimates. The basic pillars of their independence and effectiveness are: an appropriate institutional model, clearly defined remits and responsibilities, independence from political interference, highly professional staff, sufficient resources, and effective communication with the public. Their organisational structure and the concretisation of tasks within these principles and rules remain the responsibility of Member States. The number, size, remit and institutional model of independent fiscal institutions thus differ across the EU. Some Member States have had independent fiscal institutions in place for decades, but most have only had independent fiscal institutions established, or thoroughly reformed, in recent years. The only EU countries without an independent fiscal institution for monitoring compliance with numerical fiscal rules (i.e. a fiscal council), or at least a legal basis for its establishment and operation, are the Czech Republic, Poland and Slovenia.

Fiscal councils in the selected countries are mainly medium-sized, with at least some permanent staff and responsibilities that go beyond the monitoring of compliance with fiscal rules. All Member States analysed (Austria, Belgium, the Netherlands, Germany, Slovakia, Latvia), except Latvia, have medium-sized fiscal councils with at least 20 members, many of whom are often outside advisors. They are

appointed by the government together with non-governmental institutions, or elected by the parliament. The remits of fiscal councils go beyond the monitoring of compliance with fiscal rules and include the preparation of analyses of long-term fiscal sustainability and other economic analyses. In some Member States fiscal councils also formulate fiscal policy recommendations. In several countries, fiscal councils have their own budgets, whereas the fiscal councils in some countries are attached to another institution that provides them with professional and administrative support. In Austria, Belgium, the Netherlands and Germany, other independent institutions, which have more staff and are therefore able to perform more demanding tasks, also play a major role in fiscal monitoring. Independent fiscal institutions with a long-standing tradition and strong public reputation have a significant impact on public debate on fiscal policy, which is a major factor in their effectiveness.

Slovenia also faces the challenge of incorporating the reformed fiscal framework of the EU into its implementing legislation. The government proposal of the implementing act based on the amendment to the Constitution of the Republic of Slovenia from May 2013 has been in the parliamentary procedure for over half a year, for the most part in the absence of public debate or an exchange of expert opinions. It includes most of the requirements of the EU legislation and the inter-governmental fiscal compact regarding the fiscal rule and the fiscal council, but lacks solutions that are based on good practices in other countries and that take into account the existing institutional arrangement and the factors which are specific to Slovenia in this area. The current proposal for the parameters and the functioning of the fiscal rule includes certain ambiguities, on which the relatively small fiscal council will have to take a clear stand. It also lacks broad public acceptance and support***.*** The proposed method of establishing and organising the fiscal council could raise doubts about its independence and therefore damage its credibility. Alongside the fairly broad range of tasks envisaged by the law, a special challenge to the operation of a small fiscal council is the increased complexity of fiscal policy monitoring in the last few years.

Fiscal sustainability has been an issue in Slovenia for several years. Slovenia has recorded a structural deficit for at least 15 years and was therefore unable to generate a general government surplus even when its GDP growth was at its strongest. After the onset of the economic crisis, the deficit increased further amid the stronger operation of automatic stabilisers because of the crisis and the government measures put in place for mitigating its effects and stabilising the banks. Public debt thus rose from 22% of GDP in 2008 to over 80% of GDP by the end of 2014.

Consequently, the main fiscal policy objective in the years to come is fiscal consolidation, which will eliminate the structural imbalances accumulated. Thus far the fiscal consolidation measures have mainly been saving-oriented in nature. They were adopted in times of high uncertainty in Slovenia's economy when Slovenia had difficulties in accessing finance on foreign markets. However, their extension into the years that followed has revealed their weaknesses, such as their negative impact on economic activity and the undermining of other policies (e.g. the wage policy in the public sector). An even greater flaw of this approach is that it does not offer more permanent solutions for establishing fiscal sustainability, which is to be achieved by eliminating problems at their source.

The Stability Programme 2015 (SP 2015) outlines medium-term consolidation, but does not sufficiently address fiscal policy challenges. Despite the envisaged reduction in the general government deficit in the next few years, the structure of measures fails to address the main problems. In the years to come Slovenia will also not make the sufficient fiscal effort as measured by a decline in the structural deficit. Although the SP 2015 retains the focus of consolidation on the relative reduction in expenditure, it has once again significantly changed the method of consolidation. It anticipates a medium-term decline in expenditure to 2014 levels due to the envisaged reduction in interest expenditure, which is expected to compensate entirely for the increase in primary expenditure in this period. On the other hand, the PS 2015 anticipates growth in revenue for all years except 2016, when revenue will fall due to significantly lower revenue from the EU budget. Its growth will be the result of the expected recovery in economic activity, while in 2015 and 2016 it will also be due to discretionary measures: increasing the tax burden, broadening the tax bases and improving the efficiency of tax collection. The risks associated with this approach are related to the assumption of lower interest payments in the next few years amidst the persistent general government deficit, which is otherwise on the decline, but will require further borrowing. At the same time, no other measures that could reduce the debt have been defined. As in previous years, a number of measures underpinning the projections of primary expenditure are undefined and excessively focused on saving instead of a sustainable structural adjustment to the changing macroeconomic and demographic circumstances.

In order to ensure fiscal sustainability, Slovenia will therefore need to deal with the consequences of population aging and the accumulated public debt. Although Slovenia has one of the fastest ageing populations in the EU, the social protection systems in place have yet to be adapted to the changing circumstances. On the one hand, this causes difficulties in terms of providing social protection for the population while, on the other, it exerts additional pressure on public finances. As a result of the widening gap between contributions paid and pensions received, despite the reforms of 2013, the transfer from the budget to the pension fund is rising – in 2014 this figure was as high as EUR 1.6 bn. This indicates the pressing need for more radical pension reform in order to ensure more sustainable financing of the pension system. An increase in public debt to over EUR 30 bn, which reflects high general government deficits in the last few years and the extensive recapitalisations of banks and enterprises, also reveals inefficient management in state-owned enterprises. A change in management practices, or indeed privatisation, could therefore improve the efficiency of these enterprises and reduce the likelihood of further recapitalisations with public funds.

With regard to other categories of expenditure, a more selective approach to its reduction – instead of linear cuts – would ensure a more sustainable fiscal situation. This entails a detailed overview of expenditure and a programming approach to budgetary planning which would allow for a more substantive debate on the allocation of limited public resources to priority areas. This means the implementation of policies that are least harmful to the economic recovery or strengthen the economy's long-term potential.

Fiscal policy challenges

The main objective of fiscal policy is fiscal consolidation, which will eliminate the structural imbalances accumulated. Slovenia joined the list of EU countries which adopted measures during the crisis to mitigate the rise in the general government deficit and for its gradual reduction with a delay of several years. In 2012 Slovenia adopted a package of austerity measures that mainly affected earnings in the public administration, social benefits, material costs and public investment. These measures, which were comparable to those implemented in other EU Member States, reduced the general government deficit and restored investors' confidence in Slovenia's economy at a time of high uncertainty when Slovenia had difficulties in accessing finance on foreign markets. However, the extension of these measures, which were mainly savings-oriented, into the years that followed has revealed their weaknesses, such as their negative impact on economic activity and the way they undermine other policies, for example, the wage policy in the public sector. An even greater flaw in this approach is that it does not offer permanent solutions for establishing fiscal sustainability, which is to be achieved by eliminating problems at their source.

In order to ensure fiscal sustainability, Slovenia will therefore need to deal with the consequences of population ageing and the accumulated public debt. The SP 2015 outlines medium-term consolidation, but does not sufficiently address the challenges to fiscal policy. Although Slovenia has one of the fastest ageing populations in the EU, its social protection systems have yet to be adapted to the changing situation. On the one hand, this causes difficulties in ensuring social protection for the population while, on the other, it exerts additional pressure on the public finances. As the gap between contributions paid and pensions received widens, despite the reform of 2013, the transfer from the budget to the pension fund is rising – in 2014 this figure was as high as EUR 1.6 bn. This highlights the pressing need for more radical pension reform that would ensure more sustainable financing of the pension system. The increase in public debt to over EUR 30 bn, which reflects the high general government deficits in the past few years and the extensive recapitalisations of banks and enterprises, is also a sign of inefficient management in state-owned enterprises. A change in management practices, or indeed privatisation, would therefore improve the efficiency of these enterprises and reduce the likelihood of further recapitalisations with public funds.

With regard to other categories of expenditure, a more sustainable fiscal situation could be achieved through a more selective approach to expenditure reduction instead of the implementation of linear cuts. The consolidation process is also hindered by the manner in which the budget is drawn up. In circumstances where deliberations on the preparation of the budget and its structure are mainly focused on individual categories of expenditure (such as earnings, material costs, etc.) for budget users, it is difficult to conduct rationalisation on the basis of the tasks they perform. Shifting attention to individual projects would ensure a more transparent approach to budgeting and a more transparent way of managing budgetary funds. It would also enable their rationalisation on the basis of predetermined priorities, and the implementation of policies that are least harmful to the recovery or strengthen the long-term potential of the economy.

Stronger institutional monitoring focused on the enforcement of long-term professional decisions would significantly contribute to the effectiveness of consolidation. The vast majority of EU Member

States have established an institutional framework for conducting a more sustainable fiscal policy by means of independent fiscal councils which monitor fiscal policy compliance according to predetermined rules. Slovenia has yet to establish a formal system of independent fiscal policy monitoring. The fiscal rule has already been incorporated into the constitution but has not yet been defined at the operational level. These issues should therefore be dealt with as soon as possible. The experience of countries with a long tradition of effective fiscal policy monitoring has demonstrated the importance of fiscal councils' independence and the expert knowledge of their staff. The effectiveness of the monitoring process is also ensured by taking into account the characteristics of the existing institutional framework rather than simply transplanting EU rules into the domestic environment